Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90

COMMENTS OF ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.

Alaska Communications Systems Group, Inc. ("ACS")[1] hereby submits these comments in response to the Public Notice "Wireline Competition Bureau Announces Availability Of Version 3.1.2 Of The Connect America Fund Phase II Cost Model And Adds Additional Discussion Topics To Connect America Cost Model Virtual Workshop,"[2] in which it seeks additional input on a number of ongoing issues in the Connect America Phase II Cost Model Virtual Workshop, as well as new topics. ACS hereby submits comments on two of the topics raised in the Public Notice: 1) "Finalizing Input Values for Connect America Cost Model Cost Estimation Module," and 2) "Support Thresholds."

Finalizing Input Values for Connect America Cost Model Cost Estimation Module

1. The Bureau seeks comment on adopting the non-ACF default input values currently used in the cost estimation module input collections of CAM v3.1.2 for the final version of CAM. We are separately seeking comment on whether to adopt ACFs that assume an eight percent cost of capital of ACFs that assume a nine percent cost of capital in a follow-up

[1] In these comments, ACS signifies the four incumbent local exchange carrier ("ILEC") subsidiaries of Alaska Communications Systems Group, Inc.: ACS of Alaska, LLC, ACS of Anchorage, LLC, ACS of Fairbanks, LLC, and ACS of the Northland, LLC.

[2] Public Notice, "Wireline Competition Bureau Announces Availability Of Version 3.1.2 Of The Connect America Fund Phase II Cost Model And Adds Additional Discussion Topics To Connect America Cost Model Virtual Workshop," WC Docket No. 10-90, DA 13-1136. (Wireline Competition Bur., rel. May 17, 2013) *Fund Phase II Cost Model,* Public Notice in WC Docket Nos. 10-90 and 05-337, DA 13-70 (Wireline Competition Bur., rel. Jan. 17, 2013). Concurrent with this filing in the above-captioned docket, via ECFS, ACS is filing these responses to the Public Notice in the Virtual Workshop.

question to the Rate of Return virtual workshop topic. To the extent commenters argue that different inputs should be used, they should describe in detail their proposals and supply specific input values.

ACS has repeatedly documented the limitations of the Connect America Cost Model ("Model"), specifically that the Model does not offer any accommodations to address the unique difficulties and associated high costs of serving insular price cap local exchange carrier ("LEC") areas.[3] While ACS submitted for review by the Bureau its own model of the satellite, microwave, and undersea cable transport costs inherent in serving Alaska,[4] ACS has continued working on a proposal of adjustments to the Model that will address the unique demands and costs of providing voice and broadband service in Alaska. ACS expects to submit these proposed adjustments in the coming weeks. In the meantime, ACS urges the Bureau to consider a number of varying factors that significantly raise the costs to provide service in Alaska.

Higher costs in Alaska are not indicative of either inefficiencies or opportunities for cost savings. As a company that is facing more intense competition more pervasively across its service territory than any other price cap carrier, ACS is compelled by market forces to operate efficiently. Costs for providing service in Alaska are driven by the extremes in the state's remote location, challenging geography and climate, and the associated limitations in infrastructure. As a result, network construction, operation, and maintenance practices differ from those that many carriers experience in the Lower 48, and create significantly higher costs. For example, Alaska's

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[3] *See Connect America Fund; High-Cost Universal Service Support*, Comments of Alaska Communications Systems, WC Docket Nos. 10-90 and 05-337 (filed Feb. 27, 2013).

[4] *See* Letter to Marlene H. Dortch, Secretary, Federal Communications Commission, from Karen Brinkmann, Counsel for Alaska Communications Systems, *Request for Connect America Fund Cost Models*, Public Notice in WC Docket Nos. 10-90 and 05-337, DA 11-2026 (Wireline Competition Bur., rel. Dec. 15, 2011), Submitted Pursuant to Second Protective Order in WC Docket Nos. 10-90 and 05-337, DA 12-192 (Wireline Competition Bur., rel. Feb. 10, 2012), submitting the ACS model.

climate requires network operators to bury fiber more deeply than carriers do in the Lower 48 states. Engineering standards must account for extreme temperature conditions and travel to and from distant locations adds time and cost to build and operate a network. The state's remote location translates into higher transportation, fuel, and labor costs that are unique to Alaska. Also, building, upgrading, and maintaining the network is restricted by the short summer construction season in Alaska and there are additional costs to mobilize and de-mobilize the construction effort at the beginning and end of abbreviated construction seasons, as well as higher labor costs from paying overtime necessary to achieve deployment objectives during the short season. ACS has well documented in these proceedings how these and other critical inputs represent higher costs and expenses, but also require longer build-out cycles than other carriers typically require.[5] The state's very small population base and low population density means that

[5] *See Connect America Fund; High-Cost Universal Service Support*, Comments of Alaska Communications Systems Group, Inc., WC Docket Nos. 10-90 and 05-337 (filed Feb. 1, 2012); *Connect America Fund; High-Cost Universal Service Support*, Comments of Alaska Communications Systems Group, Inc., WC Docket Nos. 10-90 and 05-337 (filed July 9, 2012); *Connect America Fund; High-Cost Universal Service Support*, Reply Comments of Alaska Communications Systems Group, Inc., WC Docket Nos. 10-90 and 05-337 (filed July 23, 2012); Letter (Ex Parte Notice) to Marlene H. Dortch, Secretary, Federal Communications Commission, from Karen Brinkmann, Counsel to Alaska Communications Systems Group, Inc., *Developing a Unified Intercarrier Compensation Regime, et al.*, CC Docket Nos. 01-92 and 96-45, WC Docket Nos. 03-109, 05-337, 07-135, and 10-90, WT Docket No. 10-208, and GN Docket No. 09-51 (filed April 27, 2012); Letter to Marlene H. Dortch, Secretary, Federal Communications Commission, from Karen Brinkmann, Counsel to Alaska Communications Systems Group, Inc., *Developing a Unified Intercarrier Compensation Regime, et al.*, CC Docket Nos. 01-92 and 96-45, WC Docket Nos. 03-109, 05-337, 07-135, and 10-90, WT Docket No. 10-208, and GN Docket No. 09-51 (filed May 11, 2012), submitted subject to Second Supplemental Protective Order in WC Docket Nos. 05-337 and 10-90; Letter (Ex Parte Notice) to Marlene H. Dortch, Secretary, Federal Communications Commission, from Richard Cameron, Assistant Vice President and Senior Counsel for Alaska Communications, *Developing a Unified Intercarrier Compensation Regime, et al.*, CC Docket Nos. 01-92 and 96-45, WC Docket Nos. 03-109, 05-337, 07-135, and 10-90, WT Docket No. 10-208, and GN Docket No. 09-51 (filed July 27, 2012); Letter (Ex Parte Notice) to Marlene H. Dortch, Secretary, Federal Communications Commission, from Richard Cameron, Assistant Vice President and Senior Counsel for Alaska

even an efficient carrier cannot achieve the purchasing power and economies of scale available to industry giants in the Lower 48 states.[6] The Bureau should not finalize input values for a national Model until it can ensure that the Model's cost module will accurately capture these differences for Alaska.

Using national average costs will result in false conclusions about the costs for carriers like ACS to provide broadband, impacting their ability to comply with the Commission's CAF Phase II broadband mandate. ACS is not able to gain the same efficiencies of scale or scope as larger price cap carriers serving more than a single state. ACS cannot average its network deployment costs across multiple states with varying cost-causative characteristics. Unlike nationwide carriers, such as AT&T and Verizon, that enjoy significant economies of scale and serve areas with widely varying costs, ACS is serving only the sparsely populated, high-cost state of Alaska. ACS cannot simply join together with other carriers to gain purchasing power or other efficiencies. In the first place, its service territory is not contiguous with those of other price cap carriers.

Communications, *Developing a Unified Intercarrier Compensation Regime, et al.*, CC Docket Nos. 01-92 and 96-45, WC Docket Nos. 03-109, 05-337, 07-135, and 10-90, WT Docket No. 10-208, and GN Docket No. 09-51 (filed August 28, 2012); Alaska Communications CAF II Model, FCC Workshop, Sept. 13-14, 2012, presentation by David Blessing, Karen Brinkmann, and Richard Cameron, available at http://transition.fcc.gov/wcb/tapd/universal_service/caf/CAF2-Alaska.pdf; FCC Connect America Phase II Cost Model Virtual Workshop, Comments by Alaska Communications Systems, http://www.fcc.gov/blog/wcb-cost-model-virtual-workshop-2012.

[6] The State of Alaska has a population density of 1.2 persons per square mile, the lowest in the nation, compared with 87.4 for the United States as a whole. The state's largest population center, Anchorage, ranks 63rd on the list of the nation's largest cities with a population of 298,610 and a population density of 171.2 persons per square mile. The two cities above and below it in population on the Census Bureau's list, Lexington, Kentucky and Stockton, California, have population densities of 1,042.8 and 4,730.1 persons per square mile respectively. *See* http://quickfacts.census.gov/qfd/states/00000.html.

Second, carriers design and build their networks differently, limiting the commonality that might facilitate efficiencies. It is unreasonable to expect that ACS's costs could ever be compared to those of a nationwide carrier, or even a regional price cap carrier serving the Lower 48 states, for the purpose of assessing efficiency. Like any other carrier in a competitive environment, ACS seeks to minimize its costs and maximize output, but the fact remains that ACS lacks the economies enjoyed by carriers serving the Lower 48.

The Model should account for these differences. Just as importantly, the Model should not assume that an "efficient" carrier will always be one of the size and scale that is common amongst the largest price cap carriers. The Communication Act provides for high cost support that is "sufficient" and "predictable," but assumptions about a provider that do not exist (such as a large price cap carrier in Alaska) will never lead to high cost support that meets the legal standards.

Indeed, on the OpEx side, the Model explicitly acknowledges differences among the expense profiles of efficient carriers, providing for seven size classifications of carriers, including extra-extra small, extra small, small, medium, and large companies segregated by urban/suburban and rural density areas. Yet even here, by classifying ACS as a "medium" carrier, the model falls short of capturing ACS's true circumstances. First, the Model defines "medium" carriers as having between 100,000 and 1 million lines. ACS, with just over 100,000 lines, falls at the very bottom of that range and, as a single-state carrier operating in an extremely challenging service area, has far more in common with carriers in the "small" category, defined as those with between 4,000 and 99,999 lines. Further, as ACS, like most carriers, continues to experience line loss, it is possible that it will fall below the 100,000-line mark before the end of the CAF Phase II build-out period.

Second, even with respect to "medium" carriers, based on "industry" data, the Model incorporates a substantial negative adjustment to the operating cost profile of carriers classified as "medium," suggesting that they are far more operationally efficient than large carriers. This suggestion stands in marked contrast to the substantial positive adjustments for the three categories of "small" carriers. The Model's hypothesis that "medium" carriers enjoy the greatest operational efficiency among all sizes of carrier is counterintuitive, and based on statistical calculations of limited validity. Specifically, there are only seven carriers within the "medium" range, and the NECA investment and expense data for those carriers, on which the Model calculation is based, vary markedly among the seven. On balance, the average investment-to-expense ratio in the raw data is much closer to that experienced by larger carriers than the results of the CostQuest data analysis ultimately reflect. It is also important to note that the expense factors employed in the CostQuest analysis represent an average of 2008, 2009, and 2010. In 2008 AT&T's operating companies in Kentucky, Arkansas, Nevada and Kansas were considered medium companies in CostQuest's analysis, but they were dropped from the subsequent data periods. Thus, for two out of the three years analyzed, the medium company group consisted of only ACS, Cincinnati Bell, Hawaiian Tel, Consolidated, Rock Hill, TDS, and PRTC. This results in there being 60 percent fewer loops and 50 percent less total plant in service in 2009 and 2010 data periods. Given the small, uneven sample size of the set of "medium" carriers, the wide range of expense ratios those data reflect, and the counterintuitive nature of the downward adjustment currently included in the Model, ACS believes that there is little empirical support for assuming that, for the same level of investment, a medium size carrier would have operating expense for cable a wire investment that is so substantially lower than that experienced by much larger companies. The only justification would be to accept the hypothesis that medium carriers

are inherently more efficient than larger carriers. Further, if the model accepts that efficient companies may have varying levels of operating expense due to size, if should also accept that different sized companies may have different levels of capital expense levels as well. Yet, the Bureau has indicated that an "efficient carrier" should have the same level of capex as the largest carriers when clearly a carrier such as ACS would pay more for the same piece of equipment than would AT&T and Verizon. As a result, ACS believes that the OpEx adjustment for "medium" carriers should be set to zero. This would reflect the fact that there are few "medium" carrier data points on which to make an assessment, and the fact that those data are relatively similar to the large carrier data taken as a whole.

Alternatively, for the reasons stated above, ACS believes that the Commission should reclassify ACS as a "small" carrier for purposes of the Model. ACS, as a carrier that serves a challenging service area within a single state, and a shrinking line count that barely exceeds 100,000 today, has far more in common with the carriers classified as "small" for purposes of the Model, and should be classified as such.

2. Given the fraction of costs driven by labor, commodities and electronics along with the expected changes in prices for those inputs, net of productivity gains, Bureau staff believe that it is reasonable to assume static input values in estimating costs in the CAM. To the extent parties disagree, they should specify what assumptions we should make and provide evidence on historical or expected price movements for the costs of labor, fiber, electronics, poles, conduit, and land used in network deployment to support their arguments.

ACS agrees with the Bureau that it is reasonable to use static input values when estimating costs in the Model. Some input costs may increase while others may decrease over time, but the accuracy of the Model will be diminished if changes are made to only some input values without conducting a thorough review of changes that might be appropriate for all input values and any such predictions would be speculative at best. Moreover, such a review would be

time consuming and cause delay in completing the Model and implementing CAF Phase II support. The best course is to use static input values for the covered period.

Support Thresholds

1. One possible method for establishing the support threshold would be to estimate the average revenue per user (ARPU) that could be reasonably expected from voice and broadband services and make adjustments to take into account that not all locations passed will necessarily subscribe to one or both services over the full term of Phase II support. Is this an appropriate way to set the support threshold?

Carriers accepting CAF Phase II support must build their network to provide voice and broadband services to all covered locations, not just the customers who subscribe to their service. Support calculations under the Model are based both on the estimated cost of delivering service to those customer locations and the amount of those costs that the carrier is expected to recover from customers who choose to subscribe to the offered service. Thus, some accommodation must be made for the fact that carriers will not receive revenue for all customer locations. If the Model estimates the cost of building a network, with costs calculated on one hundred percent of the covered locations, ACS agrees that, to reflect the carrier's prospects for cost recovery from customers, the support threshold should incorporate a suitable downward adjustment based on a realistic assessment of the portion of locations where consumers will not subscribe to the supported voice and broadband services, and therefore will not generate any revenue. Given the structure of the CACM's Support Module, adjusting down the lower benchmark is the cleanest method of incorporating a realistic take rate into the model.

2. The Bureau recognizes that there may be different take rates for standalone voice service, standalone broadband service, and a package that includes both voice and broadband, and that the number of locations connected (and therefore able to subscribe) will increase over time as deployment progresses. The Bureau previously sought comment (Calculating Average Per-Unit Costs) on the assumption that, on average, 80% of locations would subscribe over the Phase II time horizon, noting that take rate has a small impact on the cost per location passed. (To illustrate the point, if 60% of locations subscribe at the beginning of Phase II and 100% subscribe at the end of Phase II, that would represent an average subscription rate of 80% over

the five-year period.) What assumptions for ARPU and take rate are appropriate for purposes of setting the funding threshold?

The Bureau's efforts to predict a take rate over a period of time must realistically account for the build-out of the network to all covered locations over time to meet the five-year deadline with assumptions about growth in the take rate trailing those increasing build-out requirements. At the beginning of the CAF Phase II build-out period, broadband service meeting the Commission's CAF Phase II parameters is unlikely to be available throughout the CAF Phase II support area. Moreover, even when broadband is available and affordable, there will be a learning curve as consumers gradually become educated in the capabilities and benefits of broadband. Demographics of the served areas will also impact take rates. Another factor that varies according to the carrier receiving support, but that is still a critical factor in setting a take rate for the funding threshold is the starting point of a carrier's take rate prior to receiving CAF Phase II support. A lower starting point will require a more significant increase in subscribership over the supported period, as compared with other carriers.

ACS submits that an 80% take rate is far in excess of a reasonably expected take rate for its service territory in Alaska. It greatly exceeds the current take rate of the largest broadband providers in the state. Even with the completion of a 4/1 Mbps network for supported locations in Alaska and with services offered in the proposed funding benchmark range of $40 to $50 per location per month, ACS believes the take rate for its voice and broadband services will remain substantially below the proposed 80% take rate. Based on the timing of network build-out, expected competitive pressures, and the realities of broadband adoption in Alaska, an average take rate of 80% is considerably overstated for ACS's service territory. ACS does not agree that an average take rate based on current take rates and a forecasted take rate for the end of the five-year build-out period is an appropriate factor for setting the funding threshold. This requires the

Bureau to use a starting take rate that may not be accurate for all carriers, to speculate about the take rate level in five years without having data to make reliable forecasts, and to speculate about how take rates will change over the CAF Phase II period when the rate of change is highly dependent on each carrier's market circumstances. To the extent the Commission proceeds with the use of an average take rate in setting the funding threshold, however, ACS submits that the average take rate should not exceed 50%, which is significantly higher than what ACS has experienced to date.

3. The table below shows the support threshold for various take rate-ARPU combinations. Would adopting a funding benchmark in the $40 to $50 range be a reasonable approach? To the extent commenters believe the funding threshold should set higher or lower, they should identify with specificity their underlying assumptions about ARPU and take rate.

ACS agrees that the Bureau proposal to set the funding benchmark in the $40 to $50 per location per month range is a reasonable approach. In adopting the CAF framework, the Commission established a goal to "ensure the universal availability of modern networks capable of delivering broadband and voice service to homes, businesses, and community anchor institutions" and, to measure its progress toward this goal, determined to "use the number of residential, business, and community anchor institution locations that newly gain access to broadband service."[7] Setting a funding benchmark that is too high could compromise the Commission's ability to maximize the number of customer locations that gain new access to broadband meeting the Commission's CAF Phase II requirements by forcing carriers to deploy service where the cost per location is extremely high, while bypassing locations where costs are below the funding benchmark, yet still too high to justify unsupported build-out.

[7] *Connect America Fund*, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, ¶¶ 51-52 (2011).

4. Given the Phase II budget of up to $1.8 billion, adopting a support benchmark in the $40 to $50 range could result in an extremely high-cost threshold between $145 and $155 per location passed, under version 3.1.2 of the Connect America Cost Model with default input values. Is this a reasonable range for the extremely high-cost benchmark?

If setting a funding benchmark in the $40 to $50 per location per month range results in a threshold for extremely high-cost areas between $145 and $155 per location passed, ACS believes that such a range would represent a reasonable outcome from the perspective of the Commission's policy goals, subject to an adequate budget and a reasonable allocation methodology for disbursements under the Remote Area Fund. As discussed in response to Question #3, from a policy perspective, the Commission has determined to use CAF Phase II to maximize the number of customer locations that gain new access to broadband meeting the Commission's CAF Phase II requirements. These funding thresholds would appear reasonably well calculated to pursue that outcome.

5. Are there other methods of calculating the support threshold for Connect America Phase II support? For instance, would basing the funding benchmark on a specified cost percentile, such as the 95th percentile, be appropriate? Are there other methods that the Bureau should consider?

ACS does not support a funding benchmark based on the 95th cost percentile. Setting the funding benchmark on this basis could have the effect of raising the funding threshold for CAF Phase II support above the point that would maximize the number of customer locations that gain new access to broadband meeting the Commission's CAF Phase II requirements. Rather, ACS supports a lower funding threshold that is selected on the basis of making broadband services affordable for consumers in order to maximize broadband acceptance and facilitate increases in broadband take rates. ACS believes that setting that funding threshold in the $40 to $50 range would provide consumer affordability and enable carriers to meet build out requirements. To the extent that setting the funding benchmark using a 95th percentile of costs could raise the funding

threshold above that level, it would not make broadband more affordable to more consumers, could reduce the number of customer locations that gain access to new broadband, and would not result in increased take rates in the amounts the Bureau seeks.

Respectfully submitted,

/s/

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